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VIA ELECTRONIC MAIL

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the
Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Department of the Treasury
Office of Critical Infrastructure Protection
and Compliance Policy
Room 1327
Main Treasury Building
1500 Pennsylvania Avenue NW
Washington, DC 20220

Re: FRB Docket Number R-1298
Treasury Docket Number DO-2007-0015

Dear Sir and Madam:

The National Automated Clearing House Association (“NACHA”) appreciates this opportunity to respond to the Notice of Joint Proposed Rulemaking regarding the prohibition on funding of unlawful Internet gambling (the “Proposed Rule”) issued by the Federal Reserve Board and the Department of Treasury (collectively the “Agencies”).¹

As explained in further detail below, NACHA compliments the Agencies for attempting to balance the realities of the ACH Network with the requirements of the Act. Nevertheless, NACHA has concerns about some of the practical aspects of the regulations and recommends clarifying many ambiguities. If not addressed, these issues could raise significant problems for both the interpretation and enforcement of the Proposed Rule. In addition, NACHA recognizes that financial institutions may have some concerns with the Proposed Rule to the extent it effectively expands the role of financial institutions as law enforcement agents, and may pose

¹ NACHA is a not-for-profit association that represents more than 11,000 financial institutions through direct memberships and a network of regional payments associations, and 650 organizations through its industry councils. NACHA develops operating rules and business practices for the Automated Clearing House (ACH) Network and for electronic payments in the areas of Internet commerce, electronic bill and invoice presentment and payment (EBPP, EIPP), e-checks, financial electronic data interchange (EDI), international payments, and electronic benefits services (EBS).

difficult compliance challenges generally. NACHA, however, will limit its comments to aspects of the Proposed Rule that directly impact or involve the ACH Network.

I. COMMENTS

A. Definitions

Under the definition of “Restricted Transaction,” any person “engaged in the business of betting or wagering” cannot knowingly accept “credit or the proceeds of credit extended to or on behalf of” an individual engaged in unlawful Internet gambling. NACHA recommends that the Agencies clarify in the Final Rule that this does not apply to credits to accounts held by natural persons. In other words, it is not intended to look at the stream of funds going to a consumer (the gambler), but is instead directed at accounts held by internet gambling businesses.²

B. Exemptions

ACH Systems: NACHA agrees with the Agencies that it is neither reasonable nor practical for exempted participants in ACH systems (i.e., ODFIs for ACH credit entries, RDFIs for ACH debit entries, and the ACH Operators) to identify and block, or otherwise prevent or prohibit, Restricted Transactions under the Act. NACHA also agrees that ODFIs for ACH debit entries and RDFIs for ACH credit entries are in a better position to ascertain the nature of a corporate customer’s business and ensure that the customer relationship is not used to process Restricted Transactions.

Further, NACHA does not believe it is reasonable or practical for ODFIs in an ACH credit transaction to implement policies and procedures to identify and block Restricted Transactions for the reasons cited by the Agencies. Specifically, such policies and procedures would invariably be costly and unduly burdensome for the ODFI, and there is no guarantee the consumer would understand, and thus be in a position to inform their institution, whether a particular transaction was lawful or restricted.

C. Processing of Restricted Transactions Prohibited

The regulation requires financial institutions to “identify and block restricted transactions; or otherwise prevent or prohibit the acceptance of the products or services of the designated payment system or participant in connection with restricted transactions.” It attempts to shield financial institutions from liability for not processing transactions if (1) they are Restricted Transactions; (2) they are reasonably believed to be Restricted Transactions; or (3) the financial institution is relying on a payment system rule that blocks or otherwise prevents such transactions. NACHA believes that, while this overblocking provision will not be a problem for ODFIs originating ACH debit entries, it does not sufficiently protect RDFIs receiving credit payments from liability. While an RDFI will know its customer, and the nature of its business, it will not know the purpose of *each* incoming ACH credit transaction. If the RDFI has reason to believe that some or any of the payments being made to their customer accounts may be Restricted Transactions, its only course of action would be to block all incoming ACH credits out of an abundance of caution because it cannot determine the nature of the payment.

² While the Supplemental Information appears to extend the proposed exemptions to the gambler’s bank, this is not clear in the plain language of the regulation.

Therefore, it is imperative that the overblocking provision be preserved, and it should be expanded to provide a safe harbor to RDFIs who are acting in good faith and trying to comply with the regulation or payment system rules.

Finally, NACHA agrees with the Agencies that they cannot mandate that a system or participant process any lawful gambling transactions. It will be very difficult for a financial institution to know whether a gambling transaction is lawful or unlawful based on the information available to it. Therefore, a financial institution should not be forced to process lawful gambling transaction if it chooses for business reasons not to expose itself to any potential liability. Section 5 sufficiently gives designated payment systems or participants the right to make this business decision and NACHA, therefore, supports the Agencies' approach.

D. Reasonably Designed Policies and Procedures

Due Diligence: The Agencies' recommendations regarding due diligence procedures seem consistent with the *NACHA Operating Rules*, which reflect the "Know Your Customer" principle for ODFIs and RDFIs. Relevant to the Proposed Rule, knowing one's corporate customer involves an understanding of the business they are engaged in and the types of transactions that may generally result. Moreover, financial institutions originating ACH transactions for corporate customers can stipulate through contract types of payments that cannot be originated. (In addition, the *NACHA Operating Rules* include an ODFI warranty that transactions are not unlawful).

Remedial Action: NACHA has no objection to the Agencies' expectation that a non-exempt participant has policies and procedures in place to be followed if the participant "becomes aware" that one of its customer relationships was being used to process Restricted Transactions. However, NACHA is concerned with the standard "become aware" and recommends that the Agencies clarify that this means when the financial institution has "actual knowledge" of the Restricted Transaction. As the proposed rule is currently written, it is not clear what it means to "become aware" of such a transaction having taken place. Having "actual knowledge," however, clarifies that the policies and procedures apply when the fact is brought to the attention of the person(s) at the financial institution responsible for the institution's compliance obligations with respect to that transaction.

NACHA strongly encourages ODFIs and RDFIs to include a termination provision in their commercial contracts, with such provision giving the financial institution a right to promptly terminate the contract in the event of a breach of contract (including if the bank knows that the customer is engaging in unlawful activities) or other materially adverse circumstances. NACHA believes it is a business decision for financial institutions as to whether additional remedial actions are necessary, such as imposing fines (though fines are not usually imposed by financial institutions on their customers) or restricting the customer's access to the ACH Network. NACHA would caution the Agencies, however, that burdensome expectations would be difficult to comply with on a daily basis, could drive up the cost of serving legitimate business interests, and could potentially result in an adverse competitive position vis-a-vis other institutions and legal jurisdictions.

Monitoring and Coding: NACHA does not believe that ongoing monitoring and testing should be included within the examples of the policies and procedures for ACH systems for the reasons mentioned by the Agencies. Further, NACHA agrees with the Agencies that coding to identify

and prevent Restricted Transactions is not practical. The *NACHA Operating Rules* do not currently provide a “standard entry class” code or other means for systemically identifying internet gambling transactions. We would also question the efficacy of such an approach, which in all likelihood would be unduly burdensome for financial institutions to police and determine whether their customer or another institution’s customer is correctly characterizing the nature of such a transaction given the uncertainties around lawful vs. restricted gambling transactions.

Cross-Border Relationships: NACHA generally supports the Agencies’ recommendation that Gateway Operators under U.S. jurisdiction responsible for incoming cross-border debit entries and outbound ACH credit entries have policies and procedures to ensure that the cross-border relationship is not used to facilitate Restricted Transactions. NACHA’s existing *Rules* and the forthcoming amendment to the *NACHA Operating Rules* (effective March 2009) governing cross-border transactions generally impose on these entities the same or similar duties as if that institution was the ODFI for a domestic ACH debit entry, or the RDFI for a domestic ACH credit entry. As with OFAC and other domestic and international AML compliance, they could update their databases and act accordingly to block Restricted Transactions when they are alerted to a potential problem by their correspondent banks, assuming correspondent banks are willing to cooperate in cases where the online gambling transaction may be legal in their jurisdiction.

Some financial institutions may have concerns about their liability for processing Restricted Transactions that they are unaware are restricted. If they have put into place requisite policies and procedures, but are misinformed by the correspondent bank as to the nature of the transaction or business involved, financial institutions may be held liable despite their best efforts to comply with the law. Again, NACHA is concerned with the standard proposed by the Agencies (“is found to have”) and instead believes that the policies and procedures should apply only when a financial institution specifically “has actual knowledge” that a foreign sender has sent instructions to originate ACH debit transactions to the receiving gateway operator or third-party sender that are Restricted Transactions. In addition, as the Agencies correctly note, there are limitations on the domestic Gateway Operator’s due diligence review in that it is only as effective as the information it receives. NACHA therefore understands if specific financial institutions question the value of measures that would increase their compliance costs for transaction screening, or result in potential liability resulting from jurisdictional differences. If this is the general result of implementing the Proposed Rule, much of the value to legitimate stakeholders of the ACH Network’s cross-border capabilities will unfortunately be compromised.

List of Unlawful Internet Gambling Businesses: The Agencies request comment on whether establishing and maintaining a list of prohibited Internet gambling businesses is appropriate and whether examining or accessing such a list should be included in the Regulation’s examples of policies and procedures reasonably designed to identify and block or otherwise prevent or prohibit Restricted Transactions. NACHA does not believe establishing and maintaining such a list is practical and questions the value of a list generally. As the Agencies note, any list would require ongoing monitoring and updating, and it would be difficult to ensure accuracy due to the reasons recognized by the Agencies (changing laws, changing nature and names of businesses, some transactions initiated by the entity may be legitimate, etc.). Given these limitations, we believe it would be unfair to tie liability or make other requirements on ACH participants dependant on such a list.

If, in spite of these concerns, the Agencies were to maintain a list, NACHA does not believe the scope of the exemptions should be narrowed because of the multitude of problems that could arise from such a list. If, despite these concerns, the Agencies narrow the scope of the exemptions, NACHA believes there should be a safe harbor for ACH participants who relied on the then current version of the list, even if this version was subsequently proven incomplete or inaccurate. In any event, NACHA does not believe that the private sector should be expected or required to develop and maintain such a list. This would likely be cost prohibitive, time consuming, and also raises liability issues regarding any entity that is mistakenly placed on the list. Accordingly, if the Final Rule requires the establishment of a list, we believe it should be developed and maintained by the government because it is in a better position to know the nature of a business engaged in unlawful gambling and make this information generally available to the industry.

E. Implementation Deadline

We believe that we will have to amend some of the existing *NACHA Operating Rules* to comply with the Final Rule. Therefore, NACHA requests that the Agencies adopt an effective date of a minimum of eighteen months after issuance of the Final Rule.

II. CONCLUSION

Thank you for allowing us this opportunity to respond. If I can be of further assistance, please do not hesitate to contact me at (703) 561-3975.

Sincerely,

Carrie M. Lee
Staff Attorney